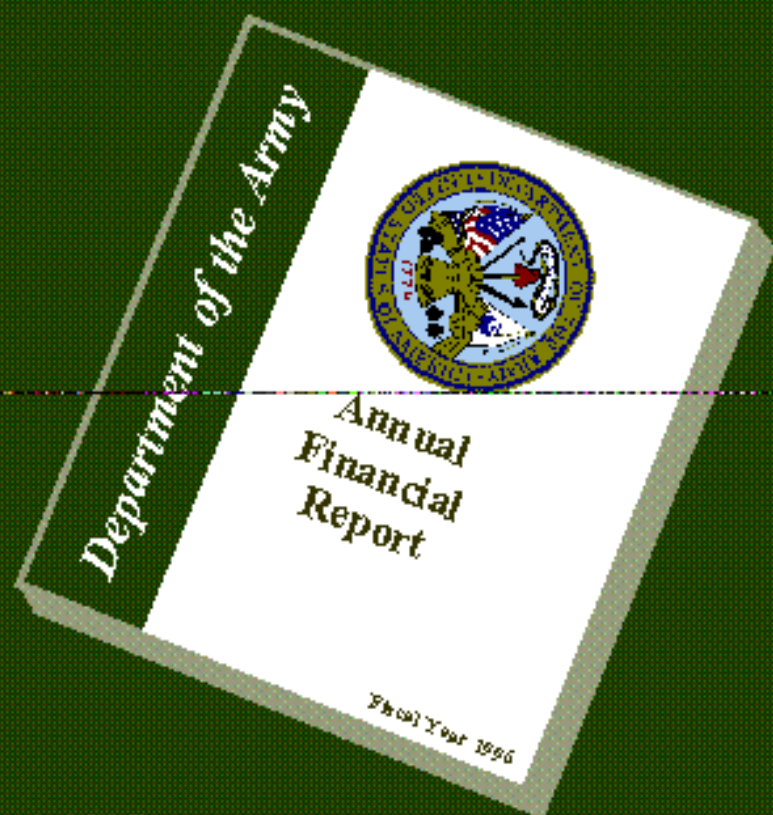


Our Destiny - Better Financial Management and Stewardship

FY 1996 Financial Activity



March 1997

***To be the best costs money. By
spending our resources carefully, we
earn a reputation for wise financial
stewardship...***

***The Army has made great strides in
financial management reform, and we
take pride in our ability to implement
business practices in a unique
organization, one entrusted with the
nation's defense...***

***We will continue our work to improve
our successful management of
resources and to amplify the United
States Army's reputation as a financial
management leader in the Department
of Defense.***

**Togo D. West, Jr.
Secretary of the Army
February 1997**

Objective

This document is designed as a *guide* to the Department of the Army FY 1996 Annual Financial Report. It is intended to provide readers with an understanding of key financial information as it relates to decision making within the Army and compliance with related legislative requirements. This guide focuses on financial and program management information from the FY 1996 Annual Financial Report for general funds, which was prepared by the Army and the Defense Finance and Accounting Service - Indianapolis Center (DFAS-IN), as required by the Chief Financial Officers Act of 1990, as amended.

Questions related to this guide or the Department of the Army FY 1996 Annual Financial Report should be addressed to:

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Our destiny- better financial management and stewardship

Organization of the Guide to the Department of the Army FY 1996 Annual Financial Report

Section I - America's Army: The Force of Decision for Today, Tomorrow, and the 21st Century provides an overview of the operational and resource challenges facing the Army today and into the future.

Section II - Financial and Program Performance Initiatives describes significant federal financial and program management reform initiatives-the Chief Financial Officers Act of 1990, the Government Performance and Results Act of 1993, Government Management Reform Act of 1994, Chief Information Officers Act of 1990, and the Federal Financial Management Improvement Act of 1996. This section also includes the ***Authoritative Accounting Guidance*** that summarizes the status of recent Statements of Federal Financial Accounting Standards (SFFAS) and Concepts adopted by the Federal Accounting Standards Advisory Board (FASAB).

Section III - Financial Management Issues discusses the Army's steps to improving financial management and the reliability of financial data.

Section IV - Department of the Army FY 1996 Annual Financial Report provides an overview of the entire general fund annual report, with emphasis on key items in the financial statements.

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The Army Vision

The world's best Army - a full spectrum force - trained and ready for victory. A total force of quality soldiers and civilians:

- *A values-based organization*
- *An integral part of the Joint Team*
- *Equipped with the most modern weapons and equipment the country can provide*
- *Able to respond to our Nation's needs*
- *Changing to meet the challenges of today...tomorrow...and the 21st century*

I. America's Army -The Force of Decision for Today, Tomorrow, and the 21st Century

Today's Army is being called upon for an increasing number, and increasing variety, of missions. The majority of the nation's commitment to operations as diverse as counterdrug, noncombatant evacuation, nation assistance, and humanitarian and disaster relief is conducted by the Army. Figure I-1 illustrates a typical day for America's Army during Fiscal Year (FY) 1996.

The Army's mission requirements will remain robust as we enter the 21st century. The frightening images of terrorism, narcotrafficking, ethnic cleansing, clan murders, and resurgent, competitive nationalism will ensure the global environment remains volatile. The Army is moving today to conceive, shape, test, and field a force prepared to meet the coming challenges.

America's 21st Century Army (Army XXI) will be a capabilities-based, technologically enhanced, power projection force, capable of providing the nation with full spectrum dominance. Army XXI will be the versatile Army with capabilities America will need in the next century.

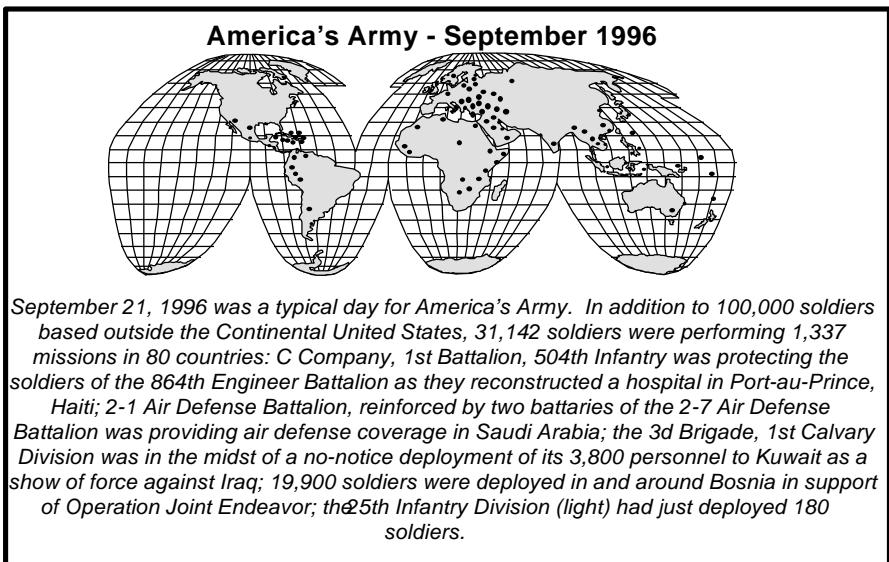


Figure I-1

Resource Challenges

The Army is meeting these operational challenges successfully, even in this era of extraordinary resource challenges. From FY 1989 - 1996, the active component of the Army was reduced in size from 18 divisions to 10-it is now only the eighth largest army in the world. The reserve component was reduced from 10 divisions to 8. Personnel reductions total well over half a million. During the same time period, the Army closed 89 bases in the United States and is in the final phase of closing 662 bases overseas.

As America's Army moves towards the 21st century, it confronts three key challenges:

- maintaining readiness,
- gaining stability in personnel, quality of life, installations, and funding, and
- becoming more efficient.

Funding

From FY 1989 - 1996, the Army's total budget (obligation) authority declined 39 percent. As illustrated in Figure I-2, the level of funding in the FY 1998 President's Budget submission for the Army equals a reduction of nearly 36 percent from FY 1989.

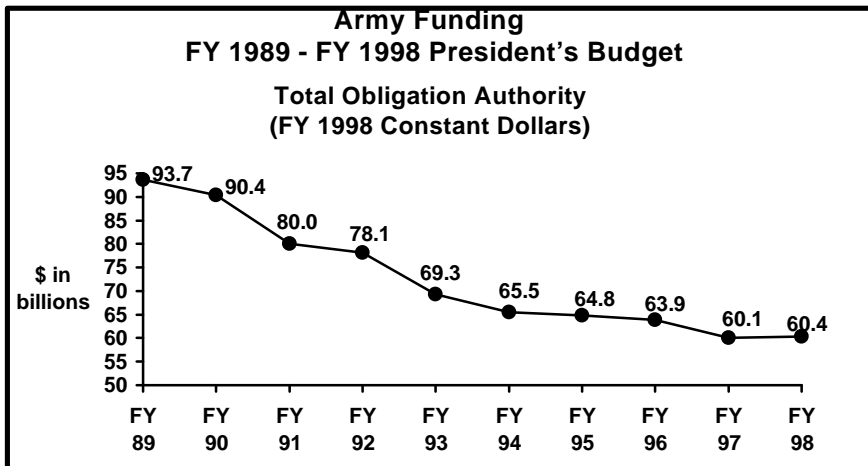


Figure I-2

The Army continues to lead the way in achieving national objectives in places like Haiti, Asia, Rwanda, the former Yugoslavia, etc. Funds to support these contingency operations are temporarily funded by

“borrowing” from readiness accounts, pending action by Congress on supplemental appropriations or reimbursement from outside sources. Funding shortfalls and the delays in supplemental funding seriously impact Army training and readiness.

Personnel

Personnel strength has declined steadily since FY 1989. Through FY 1996, military end strength decreased by over 448,000-275,000 in the active component and 173,000 in the reserve component. Civilian employees were reduced by 151,000 over the same period. Projected strength in the FY 1998 President's Budget will bring total personnel reductions to 634,000.

The Army's most important resource is its people-the Army is people. Maintaining a quality force is one of the Army's highest priorities and one of its challenges.



it is important for all of us to understand that what we do is driven by the quality people in the Army. We are a total force of quality soldiers and civilians. We must be right sized, right shaped, and properly distributed to meet the National Military Strategy.

General Dennis J. Reimer
Chief of Staff of the Army

The Army continues to have great success in attracting and retaining high quality soldiers and civilians. In FY 1996, the Active and Reserve Components achieved their quality and quantity goals for non-prior service recruits, 95 percent of whom possessed high school diplomas. The retention of quality soldiers after their first term continues to be a success. For FY 1996, the Army accomplished 100 percent of its goal for initial term reenlistment and 98 percent of its mid-career reenlistment goal.

The effects of a massive, planned drawdown in personnel, coupled with a world not envisioned seven years ago, has placed a great burden on the quality people serving our nation as soldiers and civilians. Force structure changes, base closings, early out programs, and assigning priorities have caused turbulence throughout the ranks. Throughout this difficult period, however, the soldiers and civilians of America's Army have surpassed all expectations with the dedication, energy, and flexibility in the face of any challenge.

Modernization

Modernization is the process of integrating new doctrine, organization, training, leader development, and materiel to develop and field warfighting capabilities for the Force Projection Army. Modernization is essential as the Army prepares to enter a new century.



Modernization is a continuous process essential to ensure that the Army is capable of successfully responding to our Nation's needs today and in the future.

A smaller Army requires increased lethality and modern equipment. Scarce modernization dollars require the Army to buy a limited number of new weapon systems, while extending the lives and improving the capabilities of existing systems. The modernization necessary to maintain the technological edge that allows the Army to dominate the battlefield can occur only with additional resources.

Installations

The Army is continuing to reduce its infrastructure significantly to support a smaller force that is based primarily in the continental United States. The installations that support Army forces must be world class power projection platforms and must provide quality living and working environments for soldiers, their families, and civilian workers.



The same installations must be able to deploy forces rapidly from platforms within the United States. Army installations today face tougher challenges than ever before, as years of underfunding have caused infrastructure deterioration. As the Army's budget continues to shrink, the management of installations becomes even more critical.

The realignment of Army Research Laboratory and closure of Fort Devens, Massachusetts, which lowered its flag in 1996, concluded the successful Base Realignment and Closure (BRAC) 1991 programs. The closure of Vint Hill Farms Station in Virginia, the Army's only closure in BRAC 1993, will be complete by the end of FY 1997. Work continues on the 29 closures and 11 realignments recommended by the 1995 Commission.

Installations are not just homes to soldiers and their families; each installation provides both training facilities and support services that directly contribute to unit readiness.

Challenges of Today

Resources define the readiness and capabilities of the force and impact virtually every aspect of operations. Resources affect the number and quality of soldiers and civilians, the pace of training, and the maintenance of equipment and facilities.

The Army is working to ensure there will be sufficient resources to maintain a force structure commensurate with operational commitments, to invest in essential modernization, and to enhance quality of life programs for soldiers and their families. By taking advantage of technological advances, streamlining processes, and reorganizing institutions, the Army can gain significant savings and improve its effectiveness and efficiency. Figure I-3 shows the decrease in the Army's budget authority since FY 1989.

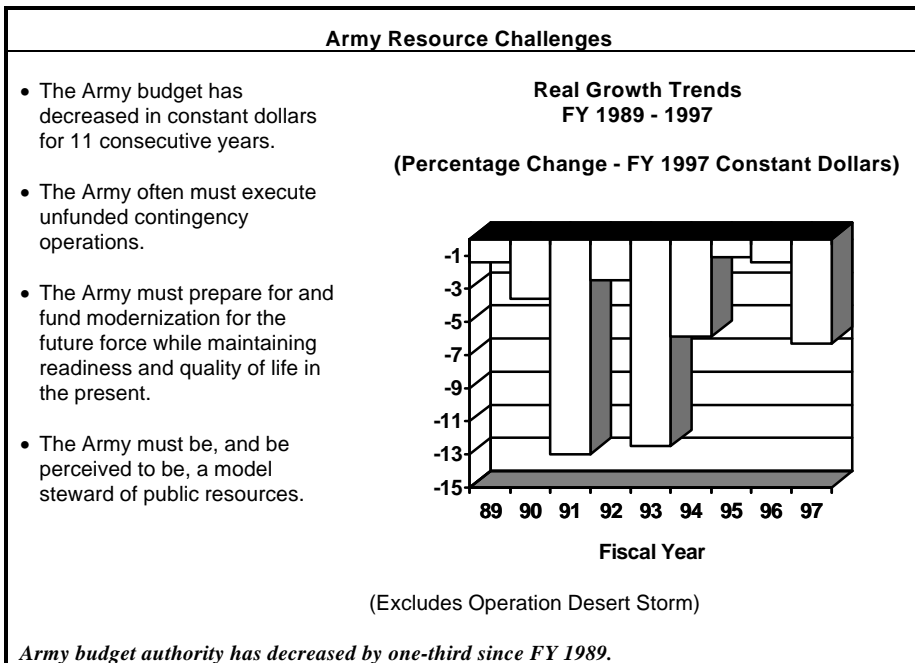


Figure I-3

II. Financial and Program Performance Initiatives

Legislative Mandates

There are number of ongoing government-wide initiatives that are intended to improve financial and program management within federal agencies. Among the most important are legislative initiatives that will have significant impact on managers - the Chief Financial Officers Act, the Government Performance and Results Act, the Government Management Reform Act, the Chief Information Officers Act and the Federal Financial Management Improvement Act. Taken together, these initiatives point to the inevitable transition to results-oriented program management and performance budgeting.

The Chief Financial Officers Act (CFO)

In relation to the CFO Act of 1990 (P.L. 101-576), the Army has set the standard for financial management reform within Department of Defense (DoD). The Army has successfully led initiatives to revise policies on physical inventories, valuation of assets, incorporating outcome-oriented performance measures, and restructuring the management control process. The purpose of the Act is to improve accountability and financial reporting by federal agencies. Its main objective is to provide accurate and timely financial information for decision making purposes. Its scope encompasses all operations, to include mission training, division operations, logistics, and all facets of installation management (i.e., real property, base operations, etc.). Installation commanders must emphasize operational discipline, compliance, and effective management control across their areas of responsibility.

The goal of full implementation is financial execution information for all operational functions that is integrated with program/budgetary information for all disclosure decision making, performance measurement, and accountability at all levels of management and leadership. The Act has the potential to break down the "stovepipes" that currently exist between functional and financial processes. This change from a vertical to horizontal management approach increases the ability for the installation commander to make optimal decisions.

The Government Performance and Results Act (GPRA)

The Government Performance and Results Act of 1993 (P.L. 103-62) builds on the framework of the CFO Act. Its purpose is to improve the effectiveness and accountability of federal programs by setting program goals, measuring performance against those goals, and reporting publicly on the results. The GPRA requires all federal agencies to submit strategic plans (beginning FY 1997 for FY 1998 and beyond), annual performance plans for every activity in the agency budget (beginning FY 1999), and annual reports of actual performance (beginning March 2000).

Implementing the GPRA requires developing performance measures that will link resources requested (in the annual budget and performance plan) to anticipated levels of outputs and outcomes. The Army has three pilot projects for performance measurement: the U.S. Army Research Laboratory, U.S. Corps of Engineers Civil Works National Operation and Maintenance Program, and the U.S. Army Audit Agency. In addition, the Army has several initiatives under way to become more efficient. It is expected that the annual financial reports required by the CFO Act and the annual performance reports required by the GPRA will be consolidated into single annual reports that explain the actual utilization of resources (compared with what was planned) and the corresponding results achieved.

The Government Management Reform Act (GMRA)

The Government Management Reform Act (P.L. 103-356) was drawn from provisions of the omnibus reform bill on the basis of recommendations of the National Performance Review. Title IV, which is also cited as the "Federal Financial Management Act of 1994," requires agency-wide audited financial statements for all agencies covered by the CFO Act, effective FY 1996. The law also requires a consolidated government-wide audited financial report, effective FY 1997.

The GMRA authorizes the Office of Management and Budget (OMB) (on a test basis) to adjust the frequency, due dates, and reporting requirements of any statutorily - required reports under laws for which OMB has financial management responsibility. In its

accompanying report, the Senate Committee on Governmental Affairs encouraged the Director of OMB to consider consolidating or adjusting the financial reporting requirements of a number of laws. The Army has long been an advocate of such consolidation, not just to reduce reporting requirements, but to integrate and improve the presentation of a variety of information relating to resource stewardship and accountability.

The Chief Information Officers Act (CIO)

The Chief Information Officers Act of 1996 gives agencies more flexibility in acquiring information technology and mandates that an agency's CIO and CFO work together to develop financial and performance measurement systems. Each agency will appoint a CIO to advise and recommend policy to the agency head and to develop, maintain, facilitate, evaluate, and assess information systems.

The Federal Financial Management Improvement Act (FFMIA)

The Federal Financial Management Improvement Act of 1996 requires that agencies develop and maintain financial management systems that comply substantially with federal requirements for those types of systems. Agency systems are to be audited for compliance with the Act, and agency heads are to report to the Congress on the implementation of remedial actions needed to bring systems into compliance.

Federal Management Reform Legislation

Chief Financial Officers Act of 1990

Under the terms of the CFO Act, all federal agencies must:

- Centralize financial management functions at the department and agency level under the leadership of a CFO.
- Prepare annual financial statements that conform with generally accepted accounting practices, to be certified by the department or agency inspectors general.
- Consolidate and modernize financial information systems.

Government Performance and Results Act of 1993

Under the terms of the GPRA, agencies have to:

- Develop strategic plans by September 1997 before FY 1998.
- Develop performance measures for key programs.
- Prepare annual performance plans by September 1997 for setting performance goals for FY 1999.

Government Management Reform Act of 1994

The GMRA:

- Requires agency-wide audited financial statements for all agencies covered by the CFO Act, effective FY 1996; requires a consolidated, government-wide report, beginning FY 1997.
- Authorizes the Director of OMB (on a test basis) to adjust the requirements of, or consolidate, any statutorily required reports under laws for which OMB has financial management responsibility.

The Chief Information Officers Act of 1996

Under the terms of the CIO Act:

- Each federal agency is given more flexibility in information technology product and service acquisitions, with OMB assuming a coordinating role.
- Each agency will appoint a CIO to advise and recommend policy to the agency head and to develop, maintain, facilitate, evaluate, and assess information systems.
- An agency's CIO and CFO (or comparable officials) are to develop an accounting, financial, and asset management system that is reliable, consistent, and timely.

The Federal Financial Management Improvement Act of 1996

The terms of FFMIA :

- Provide for consistency of accounting by an agency from one year to the next, and uniform accounting standards throughout the federal agencies.
- Require financial management systems to support full disclosure of financial data.
- Improve performance, productivity, and efficiency in financial management.
- Build on and complement the CFO, GPRA, and GMRA Acts.
- Increase the ability of agencies to compare spending to results of activities.

Figure II-1

Authoritative Accounting Guidance

Statements of Federal Financial Accounting Standards and Concepts are generally known as Federal Generally Accepted Principles, or FEDGAAP. The Federal Accounting Standards Advisory Board (FASAB) was established to recommend accounting standards designed to meet the needs of federal agencies and other users of federal financial information. The Secretary of the Treasury, the Director of OM, and the Comptroller General, are co-principals of the FASAB. The following Figure II-2 shows the status of Statements of Federal Financial Accounting Standards (SFFAS) and Concepts with the date of issuance.

Status of Authoritative Pronouncements

<u>Number</u>	<u>Title</u>	<u>Status</u>	<u>Date</u>
Standard No. 1	Accounting for Selected Assets & Liabilities	Final	30 Mar 1993
Standard No. 2	Accounting for Direct Loans & Loan Guarantees	Final	23 Aug 1993
Standard No. 3	Accounting for Inventory & Related Property	Final	27 Oct 1993
Standard No. 4	Managerial Cost Accounting Standards for the Federal Govt.	Final	31 Jul 1995
Standard No. 5	Accounting for Liabilities of the Federal Government	Final	Sep 1995
Standard No. 6	Accounting for Property, Plant and Equipment	Final	Jun 1996
Standard No. 7	Accounting for Revenue & Other Financing Sources	Final	10 May 1996
Standard No. 8	Supplementary Stewardship Reporting	Recommended	26 Jun 1996
Concept No. 1	Objectives of Federal Financial Reporting	Final	2 Sep 1993
Concept No. 2	Entity and Display	Final	6 Jun 1995

Figure II-2

Financial Reporting Under the CFO Act and GMRA

The annual financial statements required by the CFO Act, as amended by the GMRA, differ greatly from traditional federal financial reporting. The following narrative provides background information on financial statements, discusses key differences between the financial statement process and the budget process, and describes the importance of the associated financial statement audits.

Annual Financial Statements

Financial statements provide a historical look at an entity's financial position and the results of its operations. Over time, they are intended to provide stakeholders, including the taxpaying American public, with the same assurance of fiscal accountability that stockholders receive, by law, from publicly held corporations. The statements are not an end in themselves; much of the benefit comes from coordinating the people, systems, functional processes, and financial information to prepare them.

Financial statements are prepared based on a hierarchy of standards. With a comprehensive set of standards in place for agencies preparing annual financial statements in future years, starting FY 1998, OMB has revised the hierarchy in its "October 1996 OMB Form and Content."

Federal Hierarchy of Accounting Guidance

1. The statement of Federal Financial Accounting Standards (SFFAS) and Concepts recommended by the FASAB and agreed to by OMB, Government Accounting Office (GAO), and Treasury.
2. Interpretations issued by OMB on FASAB standards.
3. OMB guidance on Form and Contents.
4. Generally Accepted Accounting Principles (GAAP) and other authoritative standards.

Source: OMB Bulletin No. 97-01, Form and Content

Figure II-3

Just as the traditional distinction between internal and external report users is less useful in the Army, some of the traditional ways of classifying financial reports are less relevant. The bottom line for the Army is not “profit.” The underlying objectives of Army financial reporting are stewardship, accountability, operating performance, budgetary integrity, and systems and control. As the Army moves forward in financial management reform, staying abreast of updates in authoritative guidance is essential.

Financial Statement Audits

The requirement for annual financial statements includes the requirement for an independent audit of each report. Audits are conducted in accordance with prescribed procedures. The scope of the audit encompasses the financial statements and related internal controls and compliance with applicable laws and regulations. The audits force additional discipline on the process because the auditors address the same areas each year and report on progress made in correcting previously identified findings.

The Relationship Between Financial Statements and Budget

The budget formulation and execution process has been the traditional vehicle for managing federal resources. The requirement to produce proprietary financial statements began only six years ago, when the CFO Act was signed into law. Today, there are few direct relationships between federal budgets and financial statements. One of the greatest challenges facing federal managers is to enhance the utility of both documents by relating them as appropriate. Key characteristics of federal budgets and financial statements - their purpose, timing, measurement, and content - are highlighted in Figure II-4.

The differences between the financial statement preparation process and the budget formulation and execution process exemplify the difficulties the Army and other agencies have in developing auditable financial statements. Many of the existing appropriation-based and functional systems are designed to accommodate the budget process, but not the financial statement process.

Characteristics of the Budget vs. Financial Statements		
	Budget	Financial Statements
Purpose	Translates policy objectives into resource spending levels.	An actual accounting of how resources were utilized.
Timing	Completed in February/March preceding the start of the budget year. For example, the Executive Branch budget process for FY 1997 was released in March 1996.	Issued after the budget process for the next fiscal year is largely completed. For example, the financial statements for FY 1995 were due on March 1, 1996. Thus, the financial statements are not available for developing the FY 1997 budget.
Measurement	Cash basis measurement. Obligations (encumbrances) are generally recorded, with certain exceptions, when orders are placed and goods or services are requested. Outlays are recorded when obligations are paid. Receipts generally are recorded when checks are received.	Accrual basis measurement. Expenses are recorded when the government incurs a liability to pay for goods and services, and revenues are recorded when they are earned.
Content	Appropriation accounts are the budget vehicle for most federal agencies; they are generally organized by function.	Financial statements are organized by reporting entity. A reporting entity includes all the revenues and costs associated with an entity's activity, including budgetary appropriations and related salaries and other cross-functional overhead expenses.

Figure II-4

III. Financial Management Issues

Army senior leadership is committed to improving financial management. The Army and Defense Finance and Accounting Service (DFAS) continue working together to resolve issues identified in past audits and to improve the reliability of financial data. Joint financial and functional teams are developing and implementing interim measures to address system deficiencies that require long-term fixes, such as inadequate integration or interfaces between the accounting system and personnel pay, and property systems. These improvements will provide Army managers access to complete, consistent, reliable, and timely financial information to better account and budget for resources, institute internal controls over resources, and make management decisions regarding current and future resources.

Accounting Systems

The Army's financial statements are prepared from a consolidation of accounting data reported from various installation systems and the DFAS-IN Center. The overall accounting system supporting the Army consists of a variety of subsystems. Field-level accounting systems are fed from an array of inventory, property, procurement, payroll, accounts payable, and other management information systems that create the detailed subsidiary records to support the Army's consolidated financial statements. The field-level accounting systems report the accounting transactions via electronic file transfer to the Headquarters Accounting and Reporting System, located at DFAS-IN, so that financial consolidation and clearance functions can be performed. As part of the consolidation process, DFAS-IN must also record all disbursement/collection transactions made for the Army by other governmental agencies citing Army funds.

The management accounting information system currently supporting the Army is undergoing significant change. For example, conversion from the Standard Army Civilian Payroll System to the Defense Civilian Pay System is nearly complete. The active and reserve components are now paid by one system - The Defense Joint Military Pay System. Other actions affecting the current accounting systems environment include the continued consolidation of field accounting offices to centralized Operating Locations (OPLOC). These OPLOCs will help in streamlining and standardizing the flow of accounting data

used in the consolidation of the financial statements and will improve the ability of DFAS to efficiently replace existing unique systems with standardized accounting systems. And finally, all field-level accounting systems now have the capability of reporting General Ledger trial balances directly to the DFAS-IN departmental-level system.

Cash Management

The Army continues to search for methods to improve current cash management practices. Examples of cash management initiatives that have resulted from joint efforts between the Army and DFAS-IN include (1) encouraging civilian and military personnel (now mandatory for military) to elect payment of travel settlement vouchers via Direct Deposit/Electronic Fund Transfer (DD/EFT); (2) educating the vendors that provide Army goods and services on the benefits of payments via Electronic Funds Transfer (DD/EFT); (3) expanding the use of credit card purchases to reduce cash balances previously maintained by local imprest funds for use in purchasing small-dollar items; (4) reviewing existing cash holdings related to commissary change funds to determine where funds can be turned back to the Treasury because of decreasing customer requirements; and (5) decreasing the need for cash payment advances to government travelers by aggressively promoting use of the government charge card. Implementation of these initiatives allows the Army to reduce cash holding requirements, thereby minimizing the cost to Treasury of borrowing the money.

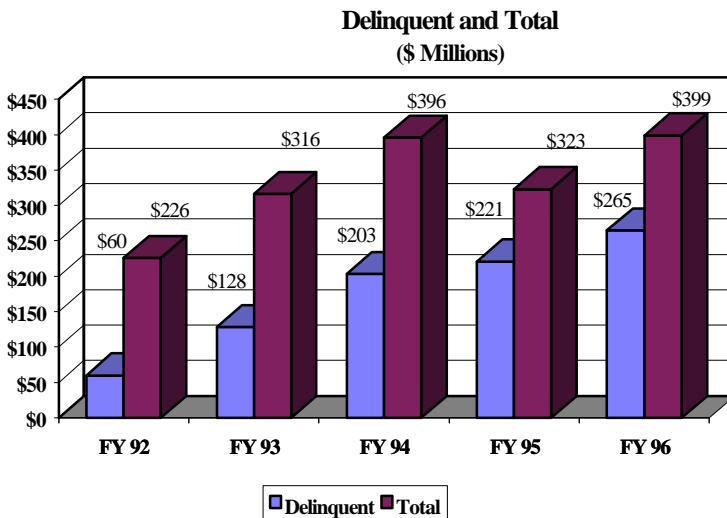
One of the most visible areas of cash management surrounds payments made to vendors under the Prompt Payment Act (PPA). In simple terms, payments must be made to vendors on time in order to avoid late payment interest penalties. Additionally, sound cash management not only involves minimizing interest charges but also includes taking full advantage of all discounts offered by vendors, where cost-effective. The Army took advantage of 87 percent of offered discounts during 1996. The Army exceeded its goal for PPA interest penalties by incurring interest penalties on only .01 percent of the total amount of disbursements subject to PPA. Fiscal year 1996 PPA interest penalty and discounts taken are presented in the chart below.

Prompt Payment Data (Thousands)

	Number	Amount
Discounts Taken	98	\$41,522
Discounts Lost	14	\$2,717
Discounts Lost (% of total)	12.5%	6%
Interest Penalties Paid Goal		2%
Payments Made Subject to PPA	3,020	\$16,175,297
Interest Penalties Paid	88	\$1,986
Interest Penalties Paid (% of total)	2.9%	.01%
Interest Penalties Paid Goal		.02%

Debt Management

The management of accounts receivable is an important element of the Army's stewardship over public funds. This category has grown dramatically as a result of demobilization and the rapid reduction in the armed forces. Debt from former soldiers represents 40 percent of the total public receivable due to the Army. During FY 1996, the Army made some policy changes and systems improvements to increase efficiency of debt collection. The process appears to be working, as debt from former soldiers decreased from 52 percent in 1995 to 40 percent in 1996.



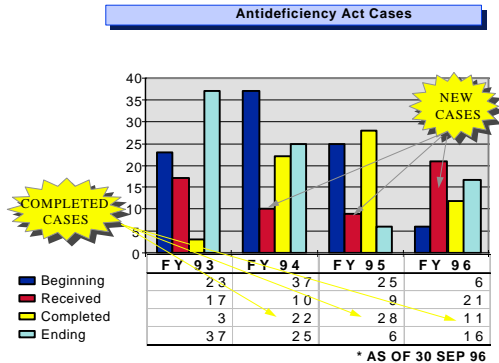
Problem Disbursements

During FY 1996, the elimination of Problem Disbursements (PD) continued to be one of the highest priorities of the Under Secretary of Defense (Comptroller). The Army transacts a significant portion of its business using a centralized clearance system at DFAS-IN that allows an installation to make disbursements citing another installation's funds. The transactions include intraservice transactions by others, interfund billings, and cross-disbursements by others. Problem disbursements represent a significant financial management concern because:

- Accuracy of accounting reports is affected.
- Availability of funds is more difficult to determine.
- The required research and resolution process becomes cumbersome with aging problem disbursements.

Reportable Antideficiency Violations

The Army had 16 potential Antideficiency Act (ADA) violations under investigation as of September 30, 1996. Of the completed cases during FY 1996, only one was determined to be a violation of the Act. The single case totaling \$100,269,900 resulted when restrictions of Section 101 of the Military Construction Act of 1994 (PL103-110) were violated. The restriction requiring prior approval by the Secretary of Defense for the expenditure of military construction funds for certain cost-plus-fixed-fees contracts has since been removed from the FY 1996 Military Construction Appropriations Act. During FY 1996, the financial management and legal communities have made significant progress in bringing ADA investigations to closure. Revisions to the ADA tracking system have provided added visibility over all phases of the process. Awareness of the fiscal constraints and ADA violations has been heightened by the preparation of an ADA primer that has been subsequently published on the ASA(FM&C) homepage of the web. Additionally, the legal community will be publishing the same document in *Army Lawyer* magazine.



Financial Management Waiver Program

The Office of the Assistant Secretary of the Army (Financial Management and Comptroller) Business Practices Office implemented a financial management waiver program in FY 1994.

The program focus was on improving financial management and stewardship of financial resources. The specific objective was to identify ways to generate revenues, reduce costs, streamline financial procedures, and allow for more business-like operations. Major Command (MACOM) and installation commanders were encouraged to submit suggestions to gain the authority needed to implement or test good ideas that were blocked by Office of the Secretary of Defense (OSD) or Army regulatory restrictions.

Since FY 1994, 40 waiver requests have been submitted. Of these requests, 26 were approved and/or completed, 2 are still in process, and 12 were withdrawn either because they required legislative action or were not supported by the Army headquarters.

FY	Submitted	Approved	In-Process	Withdrawn
94	2	1	0	1
95	31	20	1	10
96	7	5	1	1

IV. Department of the Army FY 1996 Annual Financial Report

The Army and DFAS-IN prepare the Army financial statements using consolidated data from various functional and financial activities. DFAS-IN reconciles the Army's general ledger, status, and expenditure data. The general ledger becomes the basis for preparing the financial statements.

The key participants in the overall annual financial report preparation process are the Office of the Secretary of the Army (OSA), OSD, DFAS, the Office of the Chief of Staff of the Army (OCSA), the Major Army Commands, and the Army Staff Principal Advisors, as shown in Figure IV-1.

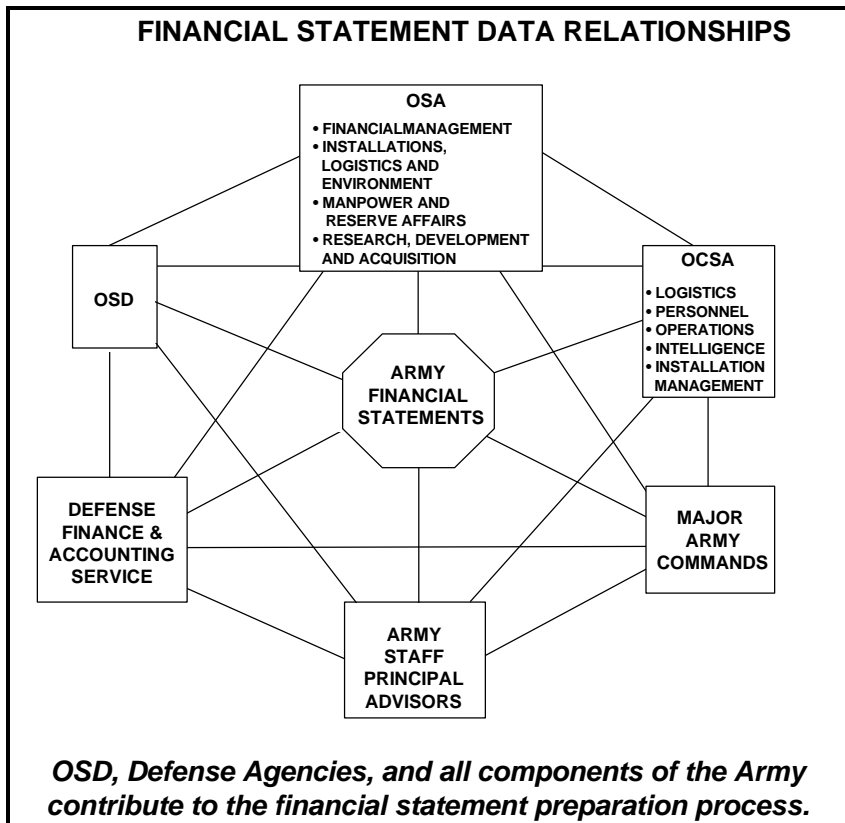


Figure IV-1

Contents of the Annual Financial Report

The Army's FY 1996 Annual Financial Report consists of four main sections based on the OMB and DoD requirements and guidelines on form and content of financial statements. These four sections are summarized in Figure IV-2 and highlighted in this discussion.

Department of the Army Annual Financial Report
Section 1 - Overview. Overview of Army missions, performance, and financial management issues.
Section 2 - Principal Statements. Financial Statements and Notes that present the Army's financial status at the end of the fiscal year.
Section 3 - Supplemental Financial and Management Information. Supplemental financial and management information or additional program and performance information not included elsewhere in the report.
Section 4 - Audit Opinion

Figure IV-2

Overview

The Overview describes the Army's missions, functional activities, significant accomplishments, performance information, and financial management issues. Contents of the FY 1996 Overview are summarized in Figure IV-3.

Contents of the Overview
America's Army provides highlights of Army accomplishments and discusses how Army missions have changed and expanded in recent years. It includes FY 1996 significant events, and notes the hard choices and resource challenges facing the Army.
Army Missions and Performance describes major functions that support the Army's principal mission of total force readiness-force structure, manning, modernization, training, mobilization and deployment, sustaining the force, installation management, information management, and military operations other than war. Goals, objectives, performance measures, and results are included.
Financial Management Issues discusses financial management challenges facing the Army, including accounting systems, cash and debt management, problem disbursements, and the financial management waiver program.

Figure IV-3

Principal Statements

The principal statements, supported by explanatory notes, are prepared to report the financial position and results of operations of the Army, pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act. These statements are similar in nature to reports produced in the private sector. Figure IV-4 provides a synopsis of each statement and shows the relationship to equivalent private sector statements.

Federal Financial Statement	Purpose	Private Sector Counterpart
Statement of Financial Position	Presents the assets, liabilities, and net position of an organization on the last day of the reporting year.	Balance Sheet
Statement of Operations and Changes in Net Position	Summarizes the sources of the organization's financial resources and how they were utilized for the reporting year.	Income Statement

Figure IV-4

The Notes to the Financial Statements are an integral part of the Financial Statements. They contain additional information necessary to make the statements more informative. They contain explanations of accounting principles and provide additional quantitative and qualitative data.

Many activities performed by the federal government are different from those performed in the private sector. As a result, the terminology used in the financial statements to report those activities may differ from private sector terminology. Figure IV-5 provides some examples of line items that are unique to the federal government or that require further explanation.

Federal Financial Statement Line Item	Explanation
Fund Balance with Treasury	The aggregate amount of the entity's accounts with Treasury for which the entity is authorized to make expenditures
Unexpended Appropriations	The amount of the entity's appropriations represented by undelivered orders and unobligated balances
Invested Capital	The net investment of the government in the entity
Program or Operation Expenses	Expenses incurred in conducting the normal activities of the department/agency
Cost of Goods or Services Sold	Costs incurred to produce products sold or provide services to the public and other federal entities. Over 80 percent of the Army's sales and related costs were intragovernmental

Figure IV-5

FASAB is developing accounting standards more suited to federal financial operations and performance measurement requirements, so the nature and appearance of federal financial statements are changing. OMB Bulletin 97-01 spells out the new formats. Under the new guidance, the Balance Sheet will remain similar in format and content, but other statements will be modified or replaced. In addition to the Balance Sheet, agencies will prepare a Statement of Net Costs, Statement of Change in Net Position, Statement of Budgetary Resources, Statement of Financing, and for some agencies, a Statement of Custodial Activity. These new formats are effective for FY 1998.

In addition to the principal statements in the new Form and Content some agencies, including the Army, will be required to report on stewardship activity. Stewardship reporting recognizes that certain assets may be most effectively presented in a separate statement along with nonfinancial data such as quantity counts and usage condition.

The following sections present key information from the Army's financial statements.

Statement of Financial Position

Comparative Statements of Financial Position (\$ in millions)		
Assets	<u>FY 1996</u>	<u>FY 1995</u>
Fund Balance with Treasury	\$31,208	\$30,017
Accounts Receivable	1,228	1,166
Inventory	37,670	1,896
Property, Plant and Equipment	124,868	155,943
Stockpile Materials	0	31,265
Other Assets	<u>6,068</u>	<u>1,433</u>
Total Assets	<u>\$201,042</u>	<u>\$221,719</u>
Liabilities		
Accounts Payable	\$3,858	\$2,378
Accrued Payroll	2,285	1,626
Other Liabilities	<u>19,166</u>	<u>6,484</u>
Total Liabilities	<u>\$25,309</u>	<u>\$10,488</u>
Net Position		
Unexpended Appropriations	\$27,462	\$27,966
Invested Capital	168,160	183,559
Cumulative Results of Operations	(1,667)	4,578
Other	0	0
Future Funding Requirements	<u>(18,222)</u>	<u>(4,872)</u>
Total Net Position	<u>\$175,733</u>	<u>\$211,231</u>
Total Liabilities and Net Position	<u>\$201,042</u>	<u>\$221,719</u>

Note: May not add due to rounding.

Figure IV-6

Assets

A breakout of total assets as shown in the statement and related Notes is shown in Figure IV-7. As illustrated, military equipment represents almost one-half of the Army's assets. Total property, plant and equipment equals over 62 percent of the Army's assets.

Total Assets-\$201.0 Billion

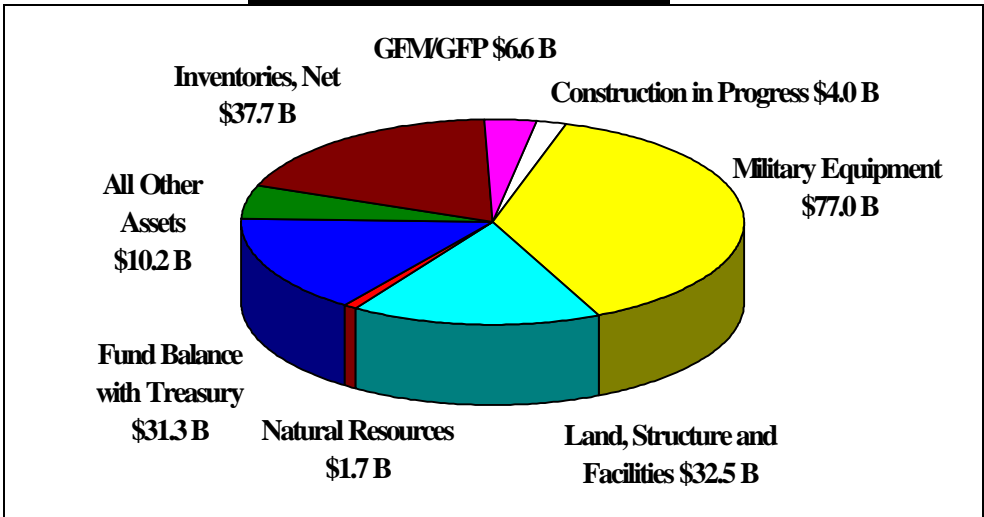


Figure IV-7

The schedule below represents the aggregate of all Army appropriations, by fund type, maintained in the Treasury accounts:

(Thousands)	Entity Assets				Total
	Trust	Revolv- ing	Appro- priated	Other Fund	
	<u>Funds</u>	<u>Funds</u>	<u>Funds</u>	<u>Types</u>	
Unobligated Balance Available:					
Available	\$403	\$63,613	\$3,101,174	\$89,702	\$3,254,892
Restricted	0	0	1,437,812	0	1,437,812
Reserve For Anticipated Resources	0	0	0	0	0
Obligated (but not expended)	77	0	26,767,296	6,073	26,773,446
Unfunded Contract Authority	0	0	(122,999)	0	(122,999)
Unused Borrowing Authority	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Treasury Balance (FY 96)	<u>\$480</u>	<u>\$63,613</u>	<u>\$31,183,283</u>	<u>\$95,775</u>	<u>\$31,343,151</u>
	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>
Treasury Balance (FY 95)	<u>\$548</u>	<u>\$159,678</u>	<u>\$29,415,831</u>	<u>\$84,888</u>	<u>\$29,660,945</u>

Figure IV-8

The components of inventory are shown in the table below:

(Thousands)	Inventory Amount	Allowance For Losses	Inventory, Net
A. Inventory Categories:			
(1) Held for Current Sale	\$1,899,923	\$0	\$1,899,923
(2) Held in Reserve for Future Sale	0	0	0
(3) War Reserve Material	35,769,856	0	35,769,856
(4) Excess, Obsolete and Unserviceable	0	0	0
(5) Held for Repair	0	0	0
Total FY 96	<u>\$37,669,779</u>	<u>\$0</u>	<u>\$37,669,779</u>

Figure IV-9

Liabilities

Accounts payable are generally recognized upon receipt of goods and services, regardless of whether they are covered by available budgetary resources. The amounts are further broken down into federal and non-federal categories in the Statement of Financial Position.

FY 1996 marks the first year that the Army recognized liabilities for environmental cleanup, DoD restructuring/downsizing, radioactive waste cleanup, and estimated actuarial liability for future workers' compensation benefits. The following schedule provides a breakout of liabilities for the majority of recorded "Other Non-Federal (Governmental) Liabilities" not covered by budgetary resources:

FY 1996 Other Liabilities (\$ in thousands)	
Downsizing-National Guard	\$177,800
Environmental Restoration	7,945,000
Former Used Defense Sites (FUDS)	5,300,000
Environmental Compliance	157,190
Low Level Radioactive Waste	283,316
Overseas Restructuring/Downsizing- Panama	430,800
Overseas Restructuring/Downsizing- Europe	146,400
Worker's Compensation	1,313,935

Net Position

Net position is composed of unexpended appropriations, invested capital, cumulative results of operations, and other and future funding requirements. Net position is presented in the following table by fund type.

	(Thousands)			
	Revolving Funds	Trust Funds	Appropriated Funds	Total
A. Unexpended				
Appropriations:				
(1)Unobligated,				
a. Available	\$0	\$403	\$3,190,876	\$3,191,279
b. Unavailable	0	0	1,314,813	1,314,813
(2)Undelivered Orders	0	18	22,955,745	22,955,763
B. Invested Capital	28,188	1,068	168,131,500	168,160,756
C. Cumulative Results				
of Operations	319,588	0	(1,987,259)	(1,667,671)
D. Other	0	0	0	0
E. Future Funding				
Requirements	(0)	(0)	(18,221,930)	(18,221,930)
Total FY	<u>\$347,776</u>	<u>\$1,489</u>	<u>\$175,383,745</u>	<u>\$175,733,010</u>

Future Funding Requirements-Accrued expenses such as annual and military leave earned but not taken are not funded in the period the expense is recorded. These future funding requirements are recognized as an offset to "net position." The following is the breakout of future funding requirements:

FUTURE FUNDING REQUIREMENTS

	(Thousands)
Other Governmental Liabilities	\$14,630,197
Annual Leave	1,486,239
Worker's Comp. and Medical Claims	769,120
Actuarial Liability for Federal Employees -	1,313,935
Future Worker's Comp Benefits	
Canceled Budget Authority (A/P)	22,437
Other	2
Total	<u>\$18,221,930</u>

Statement of Operations and Changes in Net Position

A summarized Statement of Operations and Changes in Net Position for FY 1996 is presented and compared with FY 1995 in Figure IV-10.

Comparative Statements of Operations and Changes in Net Position (\$ in millions)		
Revenues and Financing Sources	<u>FY 1996</u>	<u>FY 1995</u>
Appropriated Capital Used	\$55,644	\$53,273
Other Revenues and Financing Sources	<u>6,676</u>	<u>6,553</u>
Total Revenues and Financing	<u>\$62,320</u>	<u>\$59,826</u>
Expenses		
Program or Operation Expenses	\$57,789	\$54,476
Cost of Goods Sold	6,180	5,962
Bad Debts and Write-Offs	23	37
Other Expenses	736	359
Total Expenses	<u>\$64,728</u>	<u>\$60,834</u>
Excess (shortage) of Revenues and Financing Sources over Total Expenses	<u>(\$2,408)</u>	<u>(\$1,008)</u>

Figure IV-10

The Army's revenues and expenses are nearly equal. The Army, like most federal agencies, relies on appropriations to fund its current activities, and no significant difference between revenues and expenses is expected.

The major categories of expenses are shown in Figure IV-11. Program or Operating Expenses are 89 percent of total expenses. Figure IV-12 compares Program Expenses from FY 1993 - 1996.

FY 1996 Total Expenses
People are the Army's largest investment.

Total Expenses-\$64.7 Billion

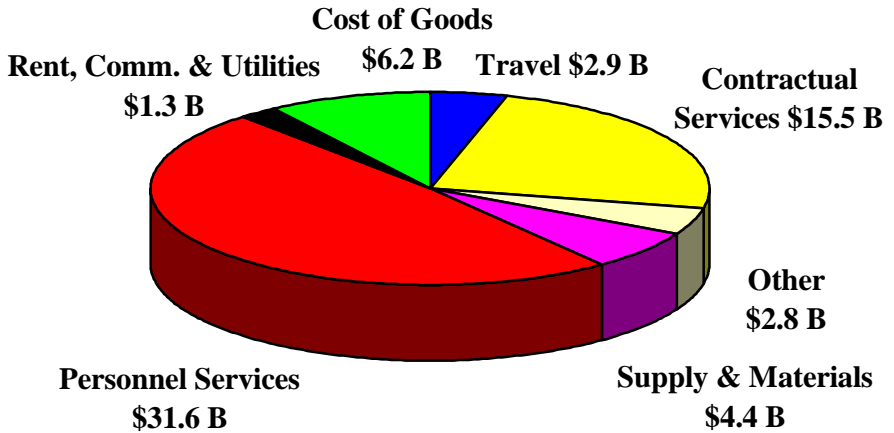


Figure IV-11

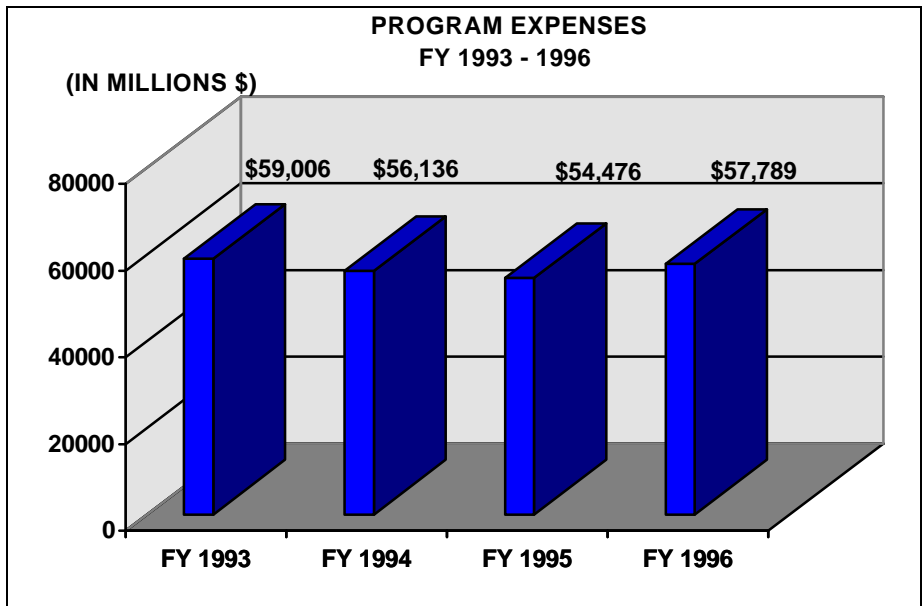


Figure IV-12

Audit Reports

Under Government Auditing Standards, independent auditors are required to report on (1) the financial statements, (2) internal controls, and (3) compliance with applicable laws and regulations. The annual audits are valuable because they include a comprehensive evaluation of the effectiveness of the Army's financial systems and internal controls leading to the auditor's report on internal controls. The internal control report sets forth reportable conditions and material weaknesses and includes the Army's progress in addressing those matters.

Auditor Opinion

FY 1996 is the sixth consecutive year the Army has undergone a financial statement audit. The Army's auditors [the General Accounting Office for FY 1991 and 1992; the US Army Audit Agency (AAA) since FY 1993] were unable to express an opinion on the financial statements taken as a whole, primarily because the accounting systems that support the financial statements do not have an integrated general ledger or produce comprehensive subsidiary ledgers.

The problem areas cited by the auditors are similar to those found in many federal agencies. Accounting systems deficiencies are the most common issues reported by auditors of federal financial statements. Figure IV-13 highlights key AAA findings for FY 1996.

Status of Audit Findings Identified in the FY 1996 Audit Report
<p style="text-align: center;"><u>Areas of Progress</u></p> <ul style="list-style-type: none"> • The Army initiated the establishment of DoD-wide Real Property Integrated Process Team. • The Army agreed to a method for revaluing the unserviceables, and this disclaimer point was resolved. • Army National Guard has identified financial reporting improvement initiatives and recognized the need to review business practices and institute improvements. • The Army submitted several inventory adjustments to improve the accuracy of the FY 1996 financial statements. • The Army continued its efforts to reduce unmatched disbursements, negative unliquidated obligations, and outstanding travel advances. • The Army leaders implemented a Velocity Management concept that focuses on improving the performance of logistics processes. This effort should speed up the supply process, reduce inventories, improve the linkage between supply and financial management systems, and provide managers with timely and accurate decision-making information.
<p style="text-align: center;"><u>Areas for Improvement</u></p> <ul style="list-style-type: none"> • The Army's accounting systems do not have integrated, transaction-driven general ledgers. • The Army should record holding gains and losses for inventory per SFFAS number 3. • Wholesale equipment wasn't properly priced or categorized, so the reported dollar value was misstated. • Dollar values for government furnished property were misstated and current accounting systems and procedures don't provide a practical method for determining a reliable dollar value. • Dollar values reported for accounts payable were not reliable, and current systems and procedures preclude a determination of the appropriate values for these accounts.

Figure IV-13

Financial Statement Audit Benefits

Audited financial statements have facilitated implementation of the CFO and GMRA, OMB and DoD guidance, and generally accepted accounting standards. Audit recommendations and the audit processes have increased the quality of the financial statements by providing a valuable learning experience to Army and DFAS-IN. CFO Act audits have brought accuracy to DOD's financial management problems and focused attention on the needed solutions.

America's Army

Our destiny-

better financial management and stewardship